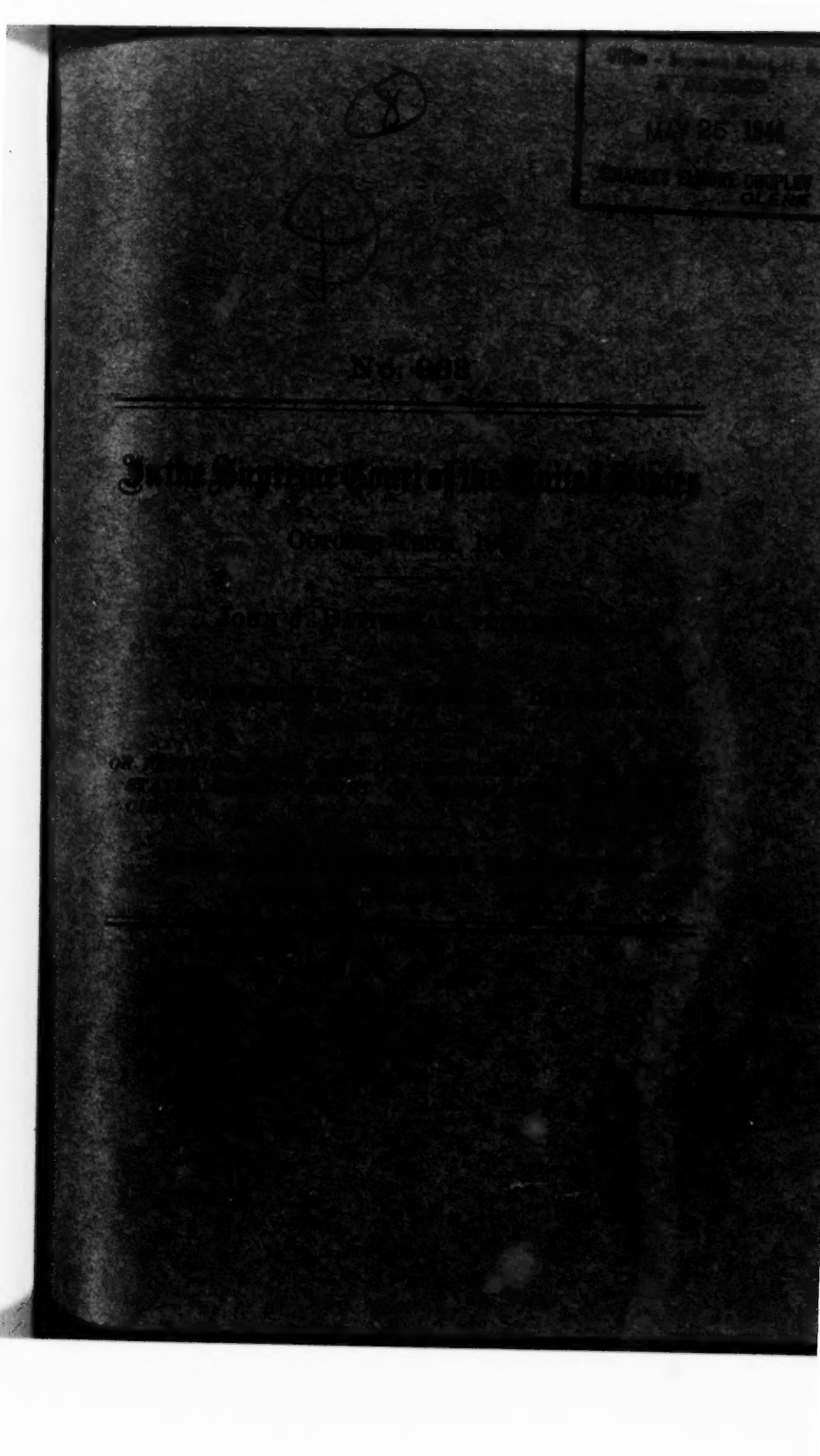
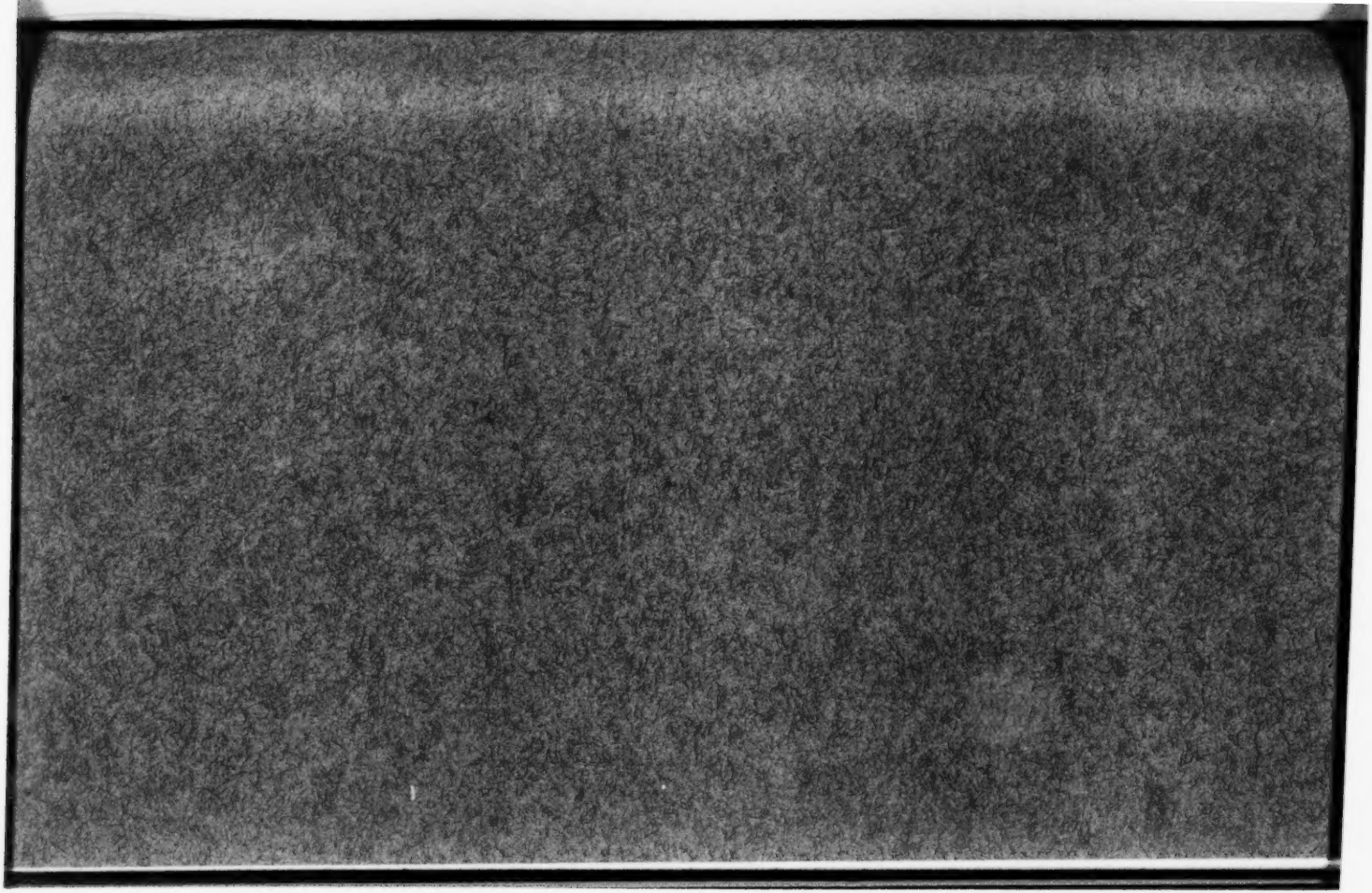




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589311—44

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 963

JOHN J. BATTERMAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 136–149) are not officially reported. The Circuit Court of Appeals did not enter an opinion.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 25, 1944. (R. 163.) The petition for a writ of certiorari was filed May 4, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the transfer of certain shares of stock in a corporation to the taxpayer, the president and general manager of the corporation, by an important stockholder of the corporation, was a gift exempt from income tax under Section 22 (b) of the Revenue Act of 1936.

2. Whether the value of the stock so transferred was correctly determined by the Tax Court.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> (b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:
>
> * * * * *

(3) *Gifts, bequests, and devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 22 (a)–3. *Compensation paid other than in cash.*—If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. * * *

STATEMENT

This matter was heard before the Tax Court of the United States on a stipulation of facts with attached exhibits (R. 15–68) and on the evidence of the parties (R. 73–134). The following statement is based on the Tax Court's findings of fact, which are not challenged by petitioner (R. 136–142).

On November 16, 1931, the taxpayer entered into an employment contract with the Gabriel Company, an Ohio corporation engaged in the manufacture of automobile shock absorbers, as assistant manager for a period of five years at an annual salary of $10,000 per year. On January 29, 1933, taxpayer was elected president and general manager of the corporation. The contract thus made, as well as election of the taxpayer to

the office of president of the corporation, was brought about by the taxpayer's brother-in-law, Dr. Alfred R. L. Dohme, who was the owner of 2,000 shares of Class B common stock of the Gabriel Company, all of its outstanding voting stock. (R. 136.) Besides the Class B voting stock there were also outstanding 198,000 shares of Class A common stock which had no voting rights (R. 137). On November 5, 1936, the taxpayer entered into a new contract as general manager of the corporation for a further period of five years at a salary of $12,500 for the first year, and $15,000 for each subsequent year (R. 136–137). The taxpayer never received from the Gabriel Company any bonus or additional compensation, exclusive of the transfer of stock here in question (R. 140).

The Gabriel Company had for several years prior to 1936 suffered operating losses and in that year was in poor financial condition (R. 137). At the instance of taxpayer, a firm of financial experts, H. M. Preston and Company, was employed to make a survey of the company's condition. This resulted in a recommendation for the alteration of the capital structure of the company by the increase of its Class A stock to 300,000 shares, and the surrender by Dr. Dohme for cancelation of his 2,000 Class B shares in exchange for 40,000 shares of the additional issue of Class A stock. The remainder of the additional Class A shares were to be sold. (R. 137.) In January, 1936, taxpayer, Dr. Dohme, and a representative

of H. M. Preston and Company, agreed that of the 40,000 shares of Class A stock thus allotted to Dr. Dohme, he should retain 10,000 shares for himself; that out of the remaining 30,000 shares, not to exceed 20,000 shares were to be issued to H. M. Preston and Company as compensation for their services in conducting the reorganization. At the same time it was agreed that out of the remainder of the 40,000 shares allotted to Dr. Dohme, a distribution should be made to the taxpayer and to other key men in the Gabriel Company. Dr. Dohme was led to accept the allotment to him of 10,000 shares, because he concluded that his present holdings were of little value, and "that under the plan the 10,000 new shares might come to have some value in the future." He gave to the taxpayer his proxy to vote his 2,000 Class B shares in favor of the proposal. (R. 137–138.)

The plan as proposed was carried into effect. Dr. Dohme's 2,000 shares of Class B stock were voted in favor of the plan under a voting trust agreement which designated the taxpayer and two members of H. M. Preston and Company as voting trustees. (R. 138.) On December 24, 1936, Dr. Dohme received a certificate for his 10,000 shares of Class A stock. At the same time he directed the trustees to distribute the remaining 30,000 shares as follows: To H. M. Preston and Company or its nominees, an aggregate of 18,320 shares; to the taxpayer and to E. L. Beecher and L. W. Klein, employees of Gabriel Company,

the balance of the 30,000 shares in such amounts as the trustees should agree. (R. 139.) H. M. Preston and Company and its nominees actually received 18,000 shares. The taxpayer proposed that the remaining 12,000 shares should be distributed 9,000 shares to himself and 1,500 shares each to Beecher and Klein. However, of the 9,000 shares allotted to the taxpayer he subsequently sold 240 shares thereof to a disgruntled stockholder of the corporation for $960, so that on the final distribution the taxpayer received 8,760 shares. These shares were issued to the taxpayer and his wife jointly, the actual distribution being made on February 23, 1937. (R. 139.)

As bearing on the motive of Dr. Dohme in the above transactions, the Tax Court found: The taxpayer's personal associations with Dr. Dohme were unusually pleasant. Dr. Dohme considered that taxpayer and Beecher and Klein were the key men in the Gabriel Company, and he desired to give to these men a financial interest in the corporation out of whatever shares remained from the 40,000 Class A stock allotted to him. Through past experience with another corporation he had come to believe that such financial interest would act as an inducement to the taxpayer and Messrs. Beecher and Klein to take more than a normal interest in the affairs of the Gabriel Company. He also wished taxpayer to remain in the employ of the Gabriel Company, and felt that the ownership of stock in the company would be an incen-

tive to the taxpayer and to Beecher and Klein to continue to devote their best efforts to the company and enable the company to repair its fortunes and eventually give some value to Dr. Dohme's own holdings. (R. 139–140.) The Tax Court specifically found (R. 140): "The foregoing were all factors motivating his decision that stock should be given to the petitioner, and to Beecher and Klein." The actual apportionment of the shares among these three was left to the taxpayer's judgment. (R. 140.)

The Tax Court also found (R. 140) that although Dr. Dohme's "security holdings were large, and although he was a moderately wealthy man," he had never made any gifts of securities to the taxpayer other than the transfer here in question. Dr. Dohme made no gift tax returns for the year here in question, nor for any other year between 1932 and 1938. The taxpayer, in his income tax returns for the years 1938 and 1939, in which years he had sold some of the stock here in question, reported in connection with such sales, under the heading of "Cost," "No Cost—received for services rendered." (R. 140.) In its opinion (R. 147) the Tax Court said, "We conclude that the 8,760 shares of stock, and the proceeds of the sale of 240 additional shares, were received by the petitioner [taxpayer] as additional compensation."

As bearing on the value of the stock received by taxpayer, the Tax Court found (R. 141): In

the years 1935 to 1939, inclusive, the Gabriel Company sustained operating losses. In December, 1936, preceding the final transfer of the stock here in question, the stock had a book value of $2.61 per share. In the years 1935–1937 the stock of the Gabriel Company sold on the New York Stock Exchange at prices varying from a low of ⅞ in 1935 to a high of 7½ in 1937. On February 23, 1937, when the stock here in question was actually distributed to the taxpayer, sales of Gabriel Company stock were made on the New York Stock Exchange at 5⅜.

The Tax Court also found (R. 141) that the taxpayer, Messrs. Beecher and Klein, and H. M. Preston & Company, had "orally entered into what the petitioner termed a 'gentlemen's agreement' that in any one year each would try not to sell more than one-fifth of the shares he would receive." In its opinion (R. 148) the Tax Court stated, "Obviously, such evidence will not justify a holding that a binding contract was made." The Tax Court also found (R. 141) that a New York brokerage firm was granted an option to purchase 20,000 shares of Gabriel Company stock at $4 a share but never exercised the option. As to the value of the stock received by the taxpayer the Tax Court in its formal findings specifically found (R. 141):

> The 8,760 shares of The Gabriel Company stock issued to petitioner had a fair market value on February 23, 1937, of $5.375 per

share, amounting in the aggregate to $47,085.

The Tax Court concluded that this amount should have been included in petitioner's taxable income for 1937, and found a deficiency in the tax paid for that year (R. 149). The decision of the Tax Court was affirmed by the Circuit Court of Appeals without opinion (R. 163).

ARGUMENT

1. Petitioner contends that the stock in question was a gift exempt from income tax. The Tax Court found that it constituted compensation for services (R. 147). This finding is supported by the evidence that the stock was distributed to petitioner and other officials of the company (who were not related to Dr. Dohme) in the hope that this might increase the value of the stock retained by Dr. Dohme, as well as by his failure to file a gift tax return covering the transfer of the stock and by petitioner's statement on his 1938 and 1939 income tax returns that his shares were "received for services rendered" (R. 140, 113, 119). In *Bogardus* v. *Commissioner,* 302 U. S. 34, upon which petitioner relies, the opinion holding a payment to be a gift [1] emphasized the absence of "the incentive of anticipated benefit of any kind," and that the disbursements were not made by stockholders "still interested" in the success of the

[1] As to the present authority of the *Bogardus* case, see *Dobson* v. *Commissioner,* 320 U. S. 489, 494n, 498n, rehearing denied, 321 U. S. 231.

company and in the maintenance of the good will and loyalty of the employees (p. 41). Here the payment to petitioner was made by a stockholder having a substantial interest in the success of the company, for the very reasons lacking in the *Bogardus* case.

The decision below is unlike *Helvering* v. *American Dental Co.*, 318 U. S. 322, which petitioner claims to be in conflict. That case involved a forgiveness by creditors, and the Court indicated that compensation cases presented a distinct problem. The Court referred (p. 327) to the "narrow line between taxable bonuses and tax free gifts * * *," and cited with apparent approval *Noel* v. *Parrott*, 15 F. 2d 669 (C. C. A. 4th), certiorari denied, 273 U. S. 754, as approved in *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 730, which held that payment for services, even though entirely voluntary and without legal obligation, constituted taxable income.

2. The determination of value was based upon the price at which sales were made on the New York Stock Exchange on the day in question (R. 147). This is in accordance with a requirement of the Regulations that market value be used (Article 22 (a) (3), *supra*), and is clearly sufficient to support the decision (*Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37) unless some adjustment should be made, as in *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481, because of a so-called restrictive agreement.

The only evidence with regard to a restriction is taxpayer's own testimony that a gentlemen's agreement existed between himself and the other distributees to "try in case of necessity not to sell more than about one-fifth part of the total amount that each of us had in any one year" (R. 147–148). The Tax Court properly found that this did not amount to a binding agreement and therefore disregarded it.

In this situation taxpayer's reliance upon cases where the restrictive agreement made sales impossible is misplaced. Moreover, the so-called agreement was entered into voluntarily by the distributees; no restriction was forced upon the taxpayer by others as in the cases cited.

CONCLUSION

There is no conflict between the decision below and the decisions of this Court. The decision below is correct, and the petition for certiorari should be denied.

Respectfully submitted.

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